

AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE FREE STATE LEGISLATURE AND THE COUNCIL OF THE MANGAUNG LOCAL MUNICIPALITY

REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying consolidated financial statements and financial statements of the Mangaung Local Municipality (MLM), which comprise the consolidated and separate statement of financial position as at 30 June 2010, and the consolidated and separate statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

The accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP), and in the manner required by the Local Government: Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2009 (Act No. 12 of 2009) (DoRA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3) of the MFMA, my responsibility is to express an opinion on the consolidated financial statements based on conducting the audit in accordance with the International Standards on Auditing read with *General Notice 1570 of 2009*, issued in *Government Gazette 32758 of 27 November 2009*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Property, plant and equipment

4. As a result of the audit findings detailed below, I was unable to obtain sufficient appropriate audit evidence to conclude on the existence, completeness, valuation, presentation and disclosure, and rights to property, plant and equipment with a carrying value of R2 937 222 306 (2009: R2 459 723 584) as disclosed in note 4 to the separate financial statements and R4 220 930 155 (2009: R2 790 755 113) as disclosed in note 4 to the consolidated financial statements. Consequently, the accuracy, completeness and occurrence of depreciation charges on property, plant and equipment amounting to R125 349 838 (2009: R121 619 599) as presented in the separate statement of financial performance and R171 250 568 (2009: R158 909 801) in the consolidated statement of financial performance could also not be determined. The municipality and municipal entity's records did not permit the performance of reasonable alternative audit procedures.
 - (a) For assets with a carrying value of R1 907 387 539 (2009: R1 647 499 577) included in the amount disclosed in note 4 to the separate financial statements and R3 191 095 388 (2009: R1 978 531 106) in the consolidated financial statements, the descriptions, serial numbers, location and condition of items as indicated in the fixed asset register were inadequate for identification purposes. Furthermore, management did not conduct a full asset verification during the year.

- (b) The valuation roll was not reconciled with the land and buildings according to the asset register of the municipality to ensure that all properties registered in the name of the municipality are recognised as property, plant and equipment. A difference of R565 367 424 was identified between the total value of the municipality's properties according to the valuation roll and the total value of the municipality's properties according to the fixed asset register. Since the municipality's accounting records did not permit the application of reasonable alternative procedures, I was unable to confirm the completeness and valuation of land and buildings included in property, plant and equipment in note 4 to the separate and consolidated financial statements.
 - (c) An amount of R3 828 070 was disclosed as a decrease in revaluation of land and building assets in the prior year as per note 4 to the separate and consolidated financial statements. I could not be provided with detailed explanations and a breakdown of this amount. Consequently, I could not determine the completeness and valuation of the revaluation reserve, the accumulated surplus and property, plant and equipment for the current and prior year.
 - (d) Management of the municipal entity did not provide sufficient appropriate audit evidence to an amount of R9 739 899 in respect of fixed asset acquisitions as disclosed in note 4 to the consolidated financial statements.
5. The municipality has not accounted for property, plant and equipment in accordance with SA Standards of GRAP in the following respects:
- (a) Paragraph 5 of the SA Standard of GRAP, GRAP 16, *Investment property* (GRAP 16) requires an asset to be recognised as investment property when it is property held to earn rentals or for capital appreciation, or both. Paragraphs 2 and 18 of GRAP 16 require a municipality to disclose investment property separately in the financial statements. Management has not separately identified its investment property in the current and prior year and no disclosures have been made of investment property in the financial statements. Consequently, I could not obtain adequate audit assurance as to the completeness, valuation, existence, and presentation and disclosure of investment property and property, plant and equipment in the separate and consolidated financial statements for the current and prior year.
 - (b) Paragraph 6 of SA Standard of GRAP, GRAP 17, *Property, plant and equipment* (GRAP 17) requires a municipality to disclose heritage assets separately in the financial statements. Management has not completed its processes regarding the identification of heritage assets for separate disclosure in the financial statements. Consequently, I could not obtain adequate audit assurance as to the completeness, valuation, and presentation and disclosure of heritage assets as disclosed in note 4 to the separate and consolidated financial statements for the current and prior year.
 - (c) In accordance with paragraph 39 of GRAP 17, the accounting policy indicated that the MLM measured land and buildings by using the revaluation model. Contrary to the accounting policy, the city council erven listing reflected a total of 1 784 erven with zero values in the prior year which had not been revalued. Consequently, I could not obtain adequate audit assurance as to the completeness and valuation of property, plant and equipment and the revaluation reserve as disclosed in the comparative amounts of note 4 to the separate and consolidated financial statements.
 - (d) Paragraph 53 of GRAP 17 requires each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item to be depreciated separately. Paragraphs 61 and 71 require the municipality to review its assets' residual values, useful lives and depreciation method at least at each reporting date. The municipality and municipal entity has not complied with these requirements in the current and prior year. Consequently, I could not obtain adequate audit assurance as to the valuation of property, plant and equipment and the accuracy of depreciation charges as

disclosed in note 4 to the separate and consolidated financial statements for the current and prior year.

- (e) In the previous year 112 erven with a total value of R82 734 000 were included in property, plant and equipment, as disclosed in the prior year amount in note 4 to the separate and consolidated financial statements. These erven were not registered in the name of the municipality and therefore did not conform to the definition and recognition criteria of property, plant and equipment as stated in paragraphs 10 and 11 of GRAP 17 and should not be recorded as property of the municipality. Consequently, property, plant and equipment and the accumulated reserve in the prior year are overstated by R82 734 000 in the prior year. As a result of the limitation reported in paragraph 4(b) above, the impact on the current year amount could not be reliably determined.
 - (f) In the prior year 165 erven with a total value of R17 354 200 which conform to the definition and recognition criteria of property, plant and equipment as stated in paragraphs 10 and 11 of GRAP 17 and which were identified as municipal property on the erven listing, were not included in the valuation roll. Consequently, property, plant and equipment and the revaluation reserve were understated by this amount in the prior year in the separate and consolidated financial statements. As a result of the limitation reported in paragraph 4(b) above the impact on the current year amounts could not be reliably determined.
6. The accounting policy of the municipality as set out in accounting policy notes 1.9 and 1.10 requires that property, plant and equipment should be assessed for impairment at each reporting date. Management did not assess whether there was a decrease in the value of property, plant and equipment during the financial year under review and the prior year. Consequently, I could not obtain adequate audit assurance as to the valuation of the municipality's property, plant and equipment as disclosed in note 4 to the separate and consolidated financial statements.
 7. Contrary to the definition of an asset as stated in GRAP 1 and GRAP 17, all animals owned by the municipality and housed in the zoo and nature conservation areas within the Mangaung district, have not been recorded in the fixed asset register and accounted for in the financial statements. A formally approved and documented policy framework regarding the management and valuation of these animals was not in place during the year under review and the municipality has not adopted an accounting policy in this regard. Consequently, I was unable to obtain adequate audit assurance as to the completeness, valuation, existence, presentation and disclosure of, and the municipality's rights to, these assets as disclosed in note 4 to the separate and consolidated financial statements.
 8. Sufficient appropriate audit evidence could not be submitted with regard to assets under construction amounting to R431 254 847 as disclosed in note 4 to the separate and consolidated financial statements. Assets under construction were also not identified and disclosed for the municipal entity in the consolidated financial statements as required by paragraph 83(b) of GRAP 17. Since the municipality and municipal entity's accounting records did not permit the application of reasonable alternative audit procedures, I was unable to obtain all the information and explanations I considered necessary to gain adequate audit assurance as to the valuation, existence, completeness and rights to assets under construction.

Inventories

9. Inventory amounting to R42 010 584 (2009: R42 857 850) as disclosed in note 10 to the consolidated financial statements was not carried at the lower of cost or net realisable value, as required by SA Standards of GRAP, GRAP 12, *Inventories* and in line with accounting policy note 1.8. Due to the nature and volume of the items involved I could not quantify the extent by which inventory, operating expenses and retained income have been misstated.

Consumer and other receivables

10. In the prior year, journals amounting to R250 949 841 which were posted between the unallocated deposit suspense accounts and consumer and other receivables in the separate and consolidated financial statements, were not appropriately reviewed and authorised. I could therefore not determine whether these journals were valid and accurately recorded and could therefore not gain adequate audit assurance as to the valuation and presentation and disclosure of consumer receivables in the prior and current year.
11. Included in the balance of consumer debtors, as disclosed in note 13 to the separate and consolidated financial statements, were suspense accounts for unallocated deposits with a credit balance amounting to R11 546 808 (2009: R14 954 820). These unallocated deposits represent receipts that have not yet been allocated to the relevant financial statement line items as at 30 June 2010 and 30 June 2009, respectively. As these payments have not been adequately allocated subsequent to year-end, I was unable to obtain adequate audit assurance as to the completeness, valuation, presentation and disclosure, and the municipality's rights to consumer and other receivables and the completeness, accuracy and classification of service charges and other income as disclosed in the separate and consolidated financial statements.
12. Consumer receivables included in note 13 amounting to R173 874 233 (2009: R135 753 925) and other receivables included in note 11 amounting to R21 041 653 (2009: R2 506 592) in the consolidated financial statements have not been impaired in accordance with the requirements of South African Statement of Generally Accepted Accounting Practice, IAS 39 (AC 133), *Financial instruments: Recognition and measurement* (IAS 39). The municipal entity only made a general provision for doubtful receivables totalling R48 002 191 (2009: R37 476 894). As the relevant information was not available, I was not able to determine what the impairment charge should have been had IAS 39 been applied correctly. I was therefore unable to quantify the amount by which consumer and other receivables, bad debts and provision for bad debts, and accumulated surplus are misstated in this regard. No alternative procedures could be performed in this regard.
13. For several debtors included in note 13 of the consolidated financial statements amounting to R37 899 524 no payments were made for a period of two months subsequent to year end. As a result, sufficient appropriate audit evidence regarding the existence of these debtors could not be obtained. The municipal entity's records did not permit the performance of alternative audit procedures in this regard.

Non-current receivables

14. The profit on the sale of the electricity distribution department to Centlec (Pty) Ltd (Centlec) in the 2005-06 financial year, as determined by the municipality, amounted to R788 999 047 and was included in the accumulated surplus balance. There were ambiguities within the sale-of-business agreement and sufficient supporting documentation could not be obtained with regard to the basis of the valuation and the qualifications of the valuers used. Consequently, I was unable to obtain adequate audit assurance as to the valuation of the shareholders loan amounting to R657 303 374 (2009: R639 899 751) as disclosed in note 7 to the separate financial statements and the accumulated surplus amounting to R1 912 885 217 (2009: R1 614 885 453) as disclosed in the separate statement of financial position. The municipality's records did not permit the performance of reasonable alternative audit procedures.

Payables from exchange transactions

15. The municipal entity has applied for exemption from normal tax as per section 10(1)(c)(A) of the Income Tax Act of South Africa, 1962 (Act No. 58 of 1962). As at year-end the entity had not yet been granted exemption from normal tax by the Commissioner of the South African Revenue Service. In the absence of the above exemption, the entity had a present legal obligation to recognise a current tax liability as well as a deferred tax liability as required by

SA Statement of Generally Accepted Accounting Practice, IAS 12 (AC 102), *Income taxes*. This issue was also reported on in previous financial years. Due to the material effect of scope limitations, misstatements and other issues of non-compliance with SA Standards of GRAP, GRAP 9 *Revenue from exchange transactions* (GRAP 9), GRAP 17 and IAS 39 referred to in this report, I was unable to quantify the extent by which the income tax liability, deferred tax, accumulated surplus and income tax expense were misstated in this regard in the consolidated financial statements.

16. For the consolidated comparative amounts, sufficient appropriate audit evidence for adjustment journals processed against payables from exchange transactions amounting to R29 221 776 could not be provided. The municipal entity's records did not permit the performance of alternative audit procedures in this regard.

Consumer deposits

17. I was unable to confirm the existence of consumer deposits totalling R38 368 916 (2009: R33 518 852) included in the balance disclosed in note 28 to the consolidated financial statements as sufficient appropriate audit evidence could not be provided. The municipal entity's records did not permit the application of alternative audit procedures regarding consumer deposits.

Revenue

18. Accounting policy note 1.14 is not in accordance with GRAP 9, since service charges from the sale of prepaid meter vouchers was recognised immediately on receipt of cash and not only at the stage when the municipal entity no longer retains continuing managerial involvement to the degree usually associated with ownership or effective control over the goods sold. As a result, the sale of prepaid electricity revenue was incorrectly recognised as service charges revenue, instead of deferred income as required by GRAP 9 in the consolidated financial statements. Due to the volume of transactions involved and the fact that the system could not provide us with the relevant information, I could not quantify the extent to which service charges is overstated and deferred income understated in the consolidated financial statements. No alternative procedures could be performed in this regard.
19. Electricity usage differences totalling R62 609 871 (2009: R25 737 144) in value were identified between the system and the underlying meter reading books. As a result I was unable to confirm the occurrence of sale of electricity revenue as disclosed in note 32 to the financial statements. Had the electricity usage in units been captured correctly on the system, the effect would have been to decrease service charges by an amount of R62 609 871 (2009: R25 737 144), increase the value-added tax (VAT) receivable by R8 765 382 (2009: R3 603 200) and decrease consumer receivables by R71 375 253 (2009: R29 340 344) in the consolidated financial statements.
20. As a result of the matters detailed below, I was unable to obtain sufficient appropriate audit assurance as to the completeness, accuracy, occurrence, classification and cut-off of service charges revenue relating to the sale of electricity as disclosed in note 32 of the consolidated financial statements amounting to R952 760 231 (2009: R700 559 342). No alternative audit procedures could be performed in this regard:
 - (a) I was unable to obtain meter reading books substantiating revenue on sale of electricity totalling R76 953 122 in respect of the prior year.
 - (b) Evidence substantiating electronic meter device readings totalling R385 101 122 (2009: R306 748 421) as levied in the debtors' sub-ledger could not be obtained.
 - (c) An approved policy stipulating the principles to be used by management as the basis to estimate the levies charged for street and traffic light consumption amounting to R10 065 990 (2009: R9 633 036) could not be provided. The municipal entity's records did not permit the application of alternative audit procedures in this regard.

- (d) The electronic data supporting revenue from prepaid electricity sales totalling R180 089 183 (2009: R116 245 343) included in the amount as per note 32 and free services recoverable revenue totalling R33 215 925 (2009: R31 607 251) included in the amount disclosed in note 33 respectively to the consolidated financial statements could not be obtained. No alternative audit procedures could be performed in this regard.
- (e) Sufficient appropriate audit evidence in respect of public contributions revenue received for system upgrades totalling R12 267 290 (2009: R11 850 458) included in system upgrades revenue in the consolidated statement of financial performance to the consolidated financial statements.
- (f) Sufficient appropriate audit evidence for estimated consumption levied on the electricity billing system, Consbill, to the amount of R6 833 455 (2009: R4 325 586) could not be obtained.
- (g) Sufficient appropriate audit evidence in respect of debit journals against service charges relating to the sale of electricity totalling R23 827 223 could not be obtained.
- (h) The completeness and accuracy of departmental consumption amounting to R8 284 536 (2009: R8 659 279), as included in service charges, could not be determined due to the lack of information regarding the apportionment of the consumption between Centlec and the parent municipality. The distinction made between the departmental consumption relating to Centlec and the electricity consumption of all buildings and equipment related to MLM which are supposed to be recovered, was therefore not clear.
- (i) Supporting evidence for prior year general ledger journals processed with an absolute value of R21 668 164 could not be obtained.
- (j) Supporting evidence for prior year subledger journals processed with an absolute value of R20 347 687 could not be obtained.

General expenditure

21. Management of the municipal entity were unable to provide me with sufficient appropriate audit evidence as to the occurrence, accuracy, completeness and classification of prior years' expenditure transactions, relating to the municipal entity, amounting to R74 038 090 of which R72 661 832 is incorporated in the accumulated surplus opening balance at 1 July 2009 presented in the consolidated statement of changes in net assets and R1 376 258 in the general expenditure of the consolidated comparative year figures. The municipal entity's records did not permit me to perform reasonable alternative audit procedures with regard to these expenditure transactions.

Cash flow statement

22. I was unable to confirm whether the consolidated cash flow statement and the related notes were fairly stated due to the material effect on the consolidated cash flow statement and related notes of scope limitations and identified misstatements as reported in this report.

Capital commitments

23. Paragraph 83(c) of GRAP 17 states that the financial statements shall disclose for each class of property, plant and equipment recognised in the financial statements the amount of contractual commitments for the acquisition of property, plant and equipment. Management did not maintain an updated contract register which provides particulars, including the committed amount, of all approved capital contracts, the expenditure incurred to date and the municipality's future capital commitments in respect of each contract in the current and previous year. I was unable to perform reasonable alternative audit procedures and consequently, I could not obtain adequate audit assurance as to the completeness, existence and valuation of capital commitments totalling R532 981 188 (2009: R527 370 241), as disclosed in note 49 to the separate financial statements and R532 981 188 (2009: R575 775 920), as disclosed in note 49 to the consolidated financial statements.

Contingent liabilities

24. The valuation and completeness of the contingent liabilities as disclosed in note 50 to the consolidated financial statements could not be determined due to the lack of information as no supporting documentation could be provided by the municipal entity. No alternative procedures could be performed in this regard.

Fruitless and wasteful expenditure

25. Although fruitless and wasteful expenditure as identified by the audit process had been disclosed in note 75 to the consolidated financial statements, the municipality and municipal entity have not further investigated their operating and capital expenditure to determine whether all matters of fruitless and wasteful expenditure have been appropriately identified, investigated and disclosed. I was unable to perform reasonable alternative audit procedures. Consequently, I could not obtain adequate audit assurance as to the accuracy and completeness of fruitless and wasteful expenditure amounting to R22 006 511 (2009: R2 763 523) as disclosed in note 75 to the consolidated financial statements.

Irregular expenditure

26. Although irregular expenditure as identified by the audit process had been disclosed in note 76 to the consolidated financial statements, the municipality and municipal entity have not further investigated their operating and capital expenditure to determine whether all matters of irregular expenditure have been appropriately identified, investigated and disclosed. I was unable to perform reasonable alternative audit procedures. Consequently, I could not obtain adequate audit assurance as to the accuracy and completeness of irregular expenditure amounting to R143 255 885 (2009: R40 777 973) as disclosed in note 76 to the consolidated financial statements.

Disclaimer of opinion

27. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the consolidated and separate financial statements of the MLM. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matters

I draw attention to the matters below. My opinion is not modified in respect of these matters:

Irregular expenditure

28. As disclosed in note 76 to the consolidated financial statements, irregular expenditure to the amount of R102 477 912 (2009: R17 637 896), was incurred during the current financial year by the municipality and the municipal entity due to non-adherence to supply chain management policy requirements. The total reported irregular expenditure that is still under investigation amounts to R143 255 885.

Fruitless and wasteful expenditure

29. As disclosed in note 75 to the consolidated financial statements, fruitless and wasteful expenditure to the amount of R19 209 989 (2009: R2 749 797), was incurred during the current financial year by the municipality and the municipal entity as a result of the reasons set out in the note. The total reported fruitless and wasteful expenditure that is still under investigation amounts to R22 006 511 (2009: R2 796 522).

Unauthorised expenditure

30. As disclosed in note 74 to the consolidated financial statements, non-budgeted expenditure to the amount of R56 213 592 (2009: R222 616 568) was incurred during the current financial year, which is regarded as unauthorised expenditure. The total reported unauthorised expenditure that is still under investigation amounts to R399 081 386 (2009: R342 867 794).

Restatement of corresponding figures

31. As disclosed in notes 52 to 70 to the consolidated financial statements, the corresponding figures for 30 June 2009 have been restated as a result of errors discovered during the 2009-10 financial year in the financial statements of the MLM at, and for the year ended, 30 June 2009.

Material impairments

32. As disclosed in note 13 to the separate and consolidated financial statements, a provision for a decrease in value to the amount of R769 615 854 (83,43%) (2009: R686 534 450 (83,98%)) and R817 618 045 (71,45%) (2009: R724 011 344 (73,08%)) respectively, has been made with regard to consumer receivables amounting to R922 495 152 (2009: R817 468 341) and R1 144 371 574 (2009: R990 699 160) respectively.

Additional matters

I draw attention to the matter below. My opinion is not modified in respect of this matter:

Unaudited supplementary schedules

33. The appendices set out on pages [xx] to [xx] do not form part of the financial statements and are presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

34. As required by the PAA and in terms of *General Notice 1570 of 2009*, issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with the following key laws and regulations: MFMA, DoRA, Local Government: Municipal System Act of South Africa, 2000 (Act No. 32 of 2000) (MSA), Municipal Supply Chain Management Regulations of South Africa (GNR.868 of 30 May 2005) (SCM regulations), Local Government: Municipal Planning and Performance Management Regulations of South Africa, 2001 (GNR.796 of 24 August 2001), and financial management (internal control).

Predetermined objectives

Material findings on the report on predetermined objectives, as set out on pages [xx] to [xx], are reported below:

Non-compliance with regulatory and reporting requirements

Existence and functioning of a performance audit committee

35. Contrary to the requirements of regulation 14(3) and 14(4) of the Municipal Planning and Performance Management Regulations, 2001, the audit committee, that also functions as the performance audit committee, did not:
- meet at least twice during the financial year
 - review the quarterly reports of the internal auditors on their audits of the performance measurements of the municipality
 - review the municipality's performance management system and make recommendations in this regard to the council of the MLM
 - submit an auditor's report to the council of the MLM regarding the performance management system at least twice during the financial year.

Internal auditing of performance measurements

36. Due to a lack of adequate resources, the internal audit department did not audit the performance measurements on a continuous basis and did not submit reports with regard to

each quarter on their audits to the municipal manager and the performance audit committee, as required by section 45 of the MSA.

Service delivery agreement

37. The service delivery agreement in place between the MLM and its municipal entity, Centlec, with regard to the provision of electricity as required by section 76 of the MSA lapsed in previous years and the new agreement was only concluded after year-end due to communication breakdowns between the MLM and Centlec. As a result, the parent municipality did not by agreement with the municipal entity establish annual performance objectives and key performance indicators for the municipal entity to be included in the entity's multi-year business plan.

Lack of adoption or implementation of a performance management system

38. The annual report of the municipal entity did not include an assessment by the municipal entity's accounting officer of the municipal entity's performance against any measurable performance objectives, set in terms of the service delivery agreement or other agreement between the municipal entity and its parent municipality, as required by section 121(4)(d) of the MFMA.
39. The above is due to the fact that the parent municipality did not include key performance indicators in the integrated development plan. Furthermore there is a lack of an effective, efficient and transparent system and internal controls regarding performance management, which describe and represent how the municipal entity's processes of performance planning, monitoring, measurement, review and reporting will be conducted, organised and managed.

Reliability of reported performance information

40. The following criteria were used to assess the reliability of the planned and reported performance:
- **Validity:** Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported performance information be traced back to the source data or documentation?
 - **Accuracy:** Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
 - **Completeness:** All actual results and events that should have been recorded have been included in the reported performance information.

The following audit findings relate to the above criteria:

Reported targets not reliable as inadequate supporting source information was provided

41. For the basic water and sanitation services objectives selected from the integrated development plan, the validity, accuracy and completeness of 22% of the reported targets could not be established, as the information provided was not based on the actual number of installations finalised, but on the deemed number of installations as per the progress payments made on the projects.

No supporting source documentation

42. Sufficient appropriate audit evidence in relation to any of the selected objectives for the municipal entity could not be obtained. There were also no satisfactory audit procedures that I could perform to obtain the required assurance as to the validity, accuracy and completeness of the reported information for the municipal entity.

Compliance with laws and regulations

Municipal Finance Management Act

The annual budget was not prepared, tabled and approved in accordance with the applicable laws and regulations

43. Contrary to the requirements of section 16(1) and (2) of the MSA, the annual budget was only tabled at a council meeting 60 days before the start of the budget year.
44. Section 88 of the MFMA was not complied with, as no supporting documentation could be submitted to prove that the accounting officer of the municipal entity has by 20 January 2010 submitted a mid-year budget and performance assessment report to the board of directors and the parent municipality. Furthermore the midyear budget and the performance assessment report were not made public for the municipal entity.

The accounting officer did not adhere to his statutory responsibilities

45. Contrary to the requirements of section 62(1)(a) and (d) of the MFMA, the accounting officer did not in certain instances adhere to his legislative responsibility of managing the financial administration of the municipality by not taking reasonable steps to ensure that:
- the resources of the municipality were used effectively, efficiently and economically in order to prevent or detect irregular, unauthorised, and fruitless and wasteful expenditure.
46. Section 127(1) of the MFMA was not complied with as the annual reports of the municipal entity for the previous four financial years were not submitted to the municipal manager of the parent municipality within the stipulated timeframe.

Municipal officials did not adhere to their statutory responsibilities

47. Contrary to the requirements of section 78(1) of the MFMA, some senior managers and some officials of the municipality, in exercising financial management responsibilities did not take reasonable steps within his/her areas of responsibility to ensure that:
- the system of financial management and internal control established for the municipality is carried out diligently in order to prevent or detect irregular, unauthorised, and fruitless and wasteful expenditure
 - the financial and other resources of the municipality were utilised effectively, efficiently, economically and transparently in order to prevent or detect irregular, unauthorised, and fruitless and wasteful expenditure
 - all revenue due to the municipality was collected
 - the assets of the municipality were managed effectively.

The audit committee was not properly established or not functioning properly

48. Contrary to the requirements of section 166(1) of the MFMA, the municipality and municipal entity did not have a functioning audit committee for the full year under review. The audit committee's extended term lapsed on 31 December 2009; therefore the committee also did not fulfil all its responsibilities as set out in section 166 of the MFMA.

Expenditure was not paid within the parameters set by the applicable legislation

49. Payments of the MLM to suppliers totalling R34 898 443 (2009: R20 052 006) were not made within 30 days of date of receipt of the relevant invoice or statement, as prescribed by section 65(2)(e) of the MFMA.
50. Section 99(2)(b) of the MFMA was not complied with as the municipal entity did not pay all invoices within 30 days of receiving thereof.

Supply chain management legislative requirements were not implemented or not adhered to (not resulting in irregular expenditure)

51. Contrary to the requirements of section 116(2)(b) and (c), capacity was not established in the municipality to ensure that contracts are properly enforced and to monitor the performance of contractors on a monthly basis.
52. Contrary to the requirements of regulation 46(2)(e) of the supply chain management regulations, section 7 of schedule 1 of the MSA and section 5A of schedule 2 of the MSA, annual declarations of all interests were not made by senior managers and some councillors.
53. Contrary to the requirements of regulation 41(2) of the supply chain management regulations, the risk assessment for the identification, consideration and avoidance of potential risks in the supply chain management system had not yet been completed at year-end.
54. Contrary to the requirements of regulation 36(2) of the supply chain management regulations, the deviations from procurement processes were not in all instances reported to the council.
55. Section 111 of the MFMA and section 2(1) of the supply chain management regulations were not complied with as the municipal entity does not have an approved and implemented supply chain management policy which resulted in the incurring of irregular, fruitless and wasteful expenditure.

The financial statements were not prepared in accordance with applicable legislation

56. Contrary to the requirements of section 122(1) of the MFMA, the municipality and its municipal entity did not prepare financial statements which fairly present the state of affairs of the municipality, its financial results, its financial position as at the end of the financial year as material adjustments had to be made to the financial statements.
57. Particulars of all non-compliance with the MFMA were not disclosed in the notes to the financial statements as required by section 125(2)(e) of the MFMA.

Expenditure was incurred otherwise than in accordance with sections 15 of the MFMA resulting in unauthorised expenditure

58. Expenditure was not incurred in accordance with the approved budget of the municipality and exceeded the limits of the amounts appropriated for four votes in the approved budget of the municipality.

Expenditure was incurred in contravention of or not in accordance with applicable legislation resulting in irregular expenditure, fruitless and wasteful expenditure

59. Expenditure was identified that was not incurred in accordance with the requirements of the MFMA, MSA and the supply chain management policy of the municipality and the expenditure was also not condoned in terms of the relevant act or regulation. In terms of the definition of irregular expenditure as set out in section 1 of the MFMA, the expenditure is regarded as irregular expenditure.
60. Section 105 of the MFMA was not complied with as the municipal entity did not take all reasonable steps to ensure that any irregular, fruitless and wasteful expenditure and other losses were prevented. Refer to notes 75 and 76 in the consolidated annual financial statements for details of incurred expenditure.

The internal audit unit was not properly established

61. Section 165(1) of the MFMA was not complied with as the municipal entity did not have a fully functioning internal audit division. The internal audit division of the parent municipality performed limited procedures and did not perform the functions as required by section 165(2) of the MFMA for the municipal entity.

Compliance with "Other enabling legislation"

62. Included in gross consumer receivables was an amount of R71 579 155 (2009: R100 581 534), which was due to the municipality by government institutions. A total of R67 719 574 (2009: R95 517 543) of this balance had been outstanding for longer than 30 days as at 30 June 2010. I could not be provided with adequate evidence that the municipality had complied with section 64(3) of the MFMA which requires the accounting officer of MLM to inform the National Treasury in writing of any payments from an organ of state in respect of municipal taxes or services which had been outstanding for longer than 30 days.

Companies Act

The statutory requirements of the Companies Act have not been complied with

63. Section 240 of the Companies Act of South Africa, 2008 (Act No. 71 of 2008) was not complied with as the register of directors' interest in contracts was not accurately kept and followed up by the municipal entity.
64. Section 179 of the Companies Act, 2008 was not complied with as the municipal entity has not held an annual general meeting for the 2008-09 financial year within the prescribed time frame.

INTERNAL CONTROL

65. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, MSA and DoRA, but not for the purposes of expressing an opinion on the effectiveness of internal control.
66. The matters reported below are limited to the significant deficiencies regarding the basis for disclaimer of opinion paragraphs, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

67. Actions to address prior year qualifications were partly implemented in the current year.
68. The leadership did not ensure that the municipality implement adequate measures to prevent and detect;
- Irregular expenditure
 - Unauthorised expenditure
 - Non-compliance with laws and regulation
69. Actions to improve on the recording and reporting of performance information still need to be enhanced.
70. A high turnover of key management positions within the municipal entity resulted in financial and risk management and internal control responsibilities not being fully achieved. After expiry of his contract, the former chief executive officer was appointed on a month-to-month basis in the prior year. His services were terminated in January 2010. The CFO has also resigned in May 2010. Since then an acting CEO and CFO were appointed. A process has been started on the filling of both positions; however, no appointments were made to date. As a result sufficient actions were not taken timeously to address audit findings and to exercise sound corporate governance within the municipal entity.
71. The results of improved communication and co-operation between the parent municipality and the municipal entity to ensure that they operate as a team to resolve identified issues and to achieve overall set objectives and service delivery became visible only during the latter part of the year under review.

72. Actions to mitigate risk were not appropriately taken as the municipal entity's audit action plan was not fully implemented in the current year.

Financial and performance management

73. Finance staff had a general lack of understanding of the GRAP accounting framework and as a result are not compiling regular, accurate and complete financial reports. The financial statements were subjected to material corrections during the audit process.
74. Limitation of scope relating to property, plant and equipment exists due to prior-year's inadequate document management procedures, a lack of capacity and expertise as well as a failure from senior management to adequately address the matters previously reported.
75. Inadequate implementation of a process to ensure that complete, timely, relevant, accurate and accessible information is available to support information included in the performance report of the municipality.
76. A lack of implementation and monitoring of controls to prevent non-compliance with laws and regulations and in particular to prevent irregular and unauthorised expenditure.
77. To date the municipal entity has shared an accounting system and bank account with the parent municipality. As a result, several controls in respect of record management do not reside at the municipal entity. Inadequate filing procedures at the parent municipality have resulted in significant limitations of scope during the current and previous year's audits. As a result, significant difficulties were experienced in respect of the availability of information. Centlec has, however, put control measures in place regarding adequate filing which resulted in an improvement as most of the information requested was provided.
78. The financial statements of the municipal entity were subjected to material corrections resulting from the audit process which are attributable to the weaknesses in design and implementation of internal control in respect of financial management, response to identified risks and weaknesses in information systems.

Governance

79. The term of the audit committee of the municipality expired in September 2009. Although the municipality started the advertising for new members in 5 October 2009 and extended the term of the audit committee to 31 December 2009, the municipality still did not have an audit committee at the date of this report as the proposal to the council was referred back. The municipal entity shares the audit committee and internal audit functions with the parent municipality.
80. Although the municipality has started to appoint additional internal auditors, all internal audits as per the internal audit plan for the year under review could not be completed timeously due to inadequate supervision in the internal audit unit. The internal audit section of the parent municipality performed limited services in respect of the municipal entity. Centlec has, however, appointed an external audit firm as internal auditors from 1 July 2010.
81. Risk management strategy for the municipality has been drafted but not yet formalised pending the approval from the council. Furthermore, an anti-corruption and fraud prevention plan has been drafted but not yet formalised pending council approval. The municipal entity's risk assessment and fraud prevention plan were not finalised/compiled and implemented during the current year.
82. Policies and procedures related to the municipal entity's financial reporting, risk management and compliance with laws and regulations were not yet drafted and functional during the current financial year and must still be developed.
83. The accounting officer of the municipal entity did not prioritise and take appropriate actions to address lack of discipline in the supply chain management directorate which resulted in irregular, fruitless and wasteful expenditure being incurred.

OTHER REPORTS

Investigations

84. During the previous year an investigation was conducted by an independent consulting firm on request of the entity. The investigation was initiated based on the allegation of possible abuse of suspense accounts by employees and had resulted in criminal proceedings being instituted against two employees. The investigation had not been completed at the date of this report and the extent of any permanent losses has not yet been established.
85. A consulting firm was appointed to conduct an investigation into the irregularities within the municipal entity relating to:
- The financial affairs
 - Policies and procedures and internal controls
 - The systems and controls at the stores that resulted in theft of materials
 - All issues reported on in the Auditor-General's report
 - Human resource process

The consulting firm was appointed on 22 February 2009 to conduct the investigation referred to above. However, up to date the firm has not been able to provide the board and the auditors with the final forensic audit report.

86. The South African Revenue Service is currently busy with an investigation with regard to revised VAT returns that have been submitted by the municipality and the municipal entity. At the date of this report the investigation was still in progress.

Performance audits

87. A performance audit commissioned by the AGSA on infrastructure has been completed, but not yet released. Due to the wide consultation at a national level, the performance audit had not been signed off by the AGSA at the date of this report.

T. Auditor - General.

Pretoria

17 December 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence